Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-838

In re

CONTINENTAL VENDING MACHINE CORP.
and CONTINENTAL APCO, INC.,
Debtors.

JAMES TALCOTT, INC.,
Petitioner,

IRVING L. WHARTON, Trustee,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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JAMES TALCOTT, INC.,

Petitioner,

IRVING L. WHARTON, Trustee,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on June 5, 1975.

Opinions Below

The opinion of the District Court for the Eastern District of New York, Appendix E, A23, is unreported. The majority and dissenting opinions of the Court of Appeals, Appendix A, A1 and A9, are reported in 517 F.2d 997 and 1002.

Jurisdiction

The judgment of the Court of Appeals was entered on June 5, 1975. Appendix B, A20. Order denying rehearing was entered on September 16, 1975. Appendix C, A21. Order denying rehearing in banc was entered on September 16, 1975. Appendix D, A22. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether, in a corporate reorganization under Chapter X of the Bankruptcy Act, 11 U.S.C. § 501 *et seq.*, it is "fair and equitable" within the meaning of § 221 of that Act, 11 U.S.C. § 621, to disregard corporate lines and to consolidate or pool assets and liabilities for purposes of dealing with unsecured claims but not to do so for purposes of dealing with secured claims.

2. If the answer is in the affirmative, whether such a consolidation is proper without exploration of the secured creditors' equities.

Statutes Involved

Bankruptcy Act, § 107, 11 U.S.C. § 507

Creditors or stockholders or any class thereof shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of a controversy, the court shall after hearing upon notice summarily determined (sic) whether any creditor or stockholder or class is so affected.

Bankruptcy Act, § 216, 11 U.S.C. § 616

A plan of reorganization under this chapter—

• • •

(6) shall specify the creditors or stockholders or any class of them not to be affected by the plan and the provisions, if any, with respect to them;

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, or such property subject to the claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, adequately and fairly provide such protection;

Bankruptcy Act, § 221, 11 U.S.C. § 621

The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

• • •

Statement

Jurisdiction of the District Court for the Eastern District of New York, the court of first instance, was invoked

under 28 U.S.C. § 1334 and section 2a(9) of the Bankruptcy Act, 11 U.S.C. § 11a(9).

Continental Vending Machine Corporation (Continental) is a publicly owned corporation in the business of designing, manufacturing, operating and selling coin-activated cigarette, beverage and food vending machines. The machines were installed and operated on locations throughout the United States.

Continental Apco, Inc. (Apco) is a wholly owned subsidiary and sales arm of Continental. It sold Continental's machines and parts to Continental's other subsidiaries, since defunct, and to the general trade.

Mismanagement and other questionable activities on the part of Continental's dominant shareholder, officer and director, Roth, led to an investigation by the Securities and Exchange Commission which resulted on April 8, 1963 in the appointment by the United States District Court for the Southern District of New York of a conservator for Continental.

On July 10, 1963 an involuntary petition was filed against Continental in the Eastern District of New York for reorganization under Chapter X of the Bankruptcy Act, 11 U.S.C. § 501 *et seq.* The order approving the petition appointed two trustees. On October 4, 1963 an involuntary petition for a Chapter X reorganization was filed against Apco, and Continental's trustees were appointed trustees for Apco. Resignation of one trustee left respondent, Irving L. Wharton, as the sole trustee for both debtors.

Petitioner, James Talcott, Inc., a factor, (A10,n.1) was the principal financier of both debtors. It made loans and advances on a secured basis. As security for Continental's obligations, petitioner received chattel mortgages and other

security devices covering vending machines on location, assignments of location contracts, liens on machines in warehouses and in other places off the locations. As security for Apco's obligations, petitioner received assignments of accounts receivable arising from sales, chattel paper and liens on machines returned by customers.

All obligations of the two debtors were covered by security agreements with each, containing identical dragnet clauses providing that all security for a specific obligation under one agreement also stood as security for all other present and future obligations whether under the particular agreement or under other agreements. Thus, whatever property of Continental came within the orbit of petitioner's security interest stood as security for all of Continental's obligations. And this was also true with respect to Apco's property held as security by petitioner. The agreements did not provide for cross-collateralization and the debtors did not guarantee each other's debts to petitioner.

At the time of appointment of the conservator, Continental's obligations to petitioner amounted to about $3,500,000 and Apco's obligations approximated $2,000,000.

Upon commencement of the conservatorship for Continental and successive reorganization proceedings of Continental and Apco, petitioner began liquidating its security which resulted in a surplus of $380,000 in the Apco account and a deficit of $820,000 in the Continental account.

While liquidating its security, petitioner, during 1963, made five urgently needed loans to the conservator and trustees, respectively, in excess of $2,000,000, secured by conservator's and trustees' certificates. These remain unpaid to the extent of over $1,000,000 inclusive of interest.

As early as 1964, it became apparent to petitioner's counsel and it advised the trustee that the affairs of the

two debtors were so intertwined that their assets, liabilities and the proceedings would have to be consolidated. Investigation led the trustee to the same conclusion. In his report pursuant to § 167(5), 11 U.S.C. § 567(5), filed on June 13, 1969, the trustee stated: There is no longer any business to be reorganized. A plan of reorganization providing for liquidation would be preferable to an adjudication in bankruptcy. The debtors were operated as a single economic unit. Any plan of reorganization should provide for a merger of their assets and liabilities and a consolidation of the two proceedings.

On June 20, 1969, the trustee filed a plan of reorganization, actually liquidation, and in his application for an amended notice of hearing, he represented: "(a) . . . Apco had, in fact, no separate economic existence, was not adequately capitalized, and constituted a mere instrumentality of the parent corporation, i.e., a separate corporate pocket or department of the parent and its business; (b) the operation of the separate entities in reality constituted a single enterprise in an economic sense." And Apco's officers and directors were not independent but were dominated by Roth.

The trustee further represented: There was such a complex pattern of fund transfers between the two debtors and of guarantees and cross-guarantees of each other's obligations that separation of their assets and liabilities was "virtually impossible." There was little likelihood of successful attempts to reconstruct intercompany transactions and no assurance of success "regardless of the amount of money, time and effort" expended. The trustee concluded that a merger of the assets and liabilities and a consolidation of the proceedings will afford "a fair, equitable and feasible solution to the insoluble problem resulting from

the indiscriminate manipulation of the debtors, and their finances."

After the amended notice of hearing, petitioner's counsel, relying on *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2 Cir. 1969), advised the trustee that because of the proposed consolidation, petitioner asserted the right to apply the Apco surplus against the Continental deficiency.

An amended plan was filed on June 15, 1970, avowedly to preclude petitioner's said claim. The relevant provisions were: Claims against both debtors are treated on a consolidated basis "except for claims of Secured Creditors." Properties of both debtors are dealt with on a consolidated basis "without prejudice to the rights of Secured Creditors with respect to specific collateral securing specific indebtedness." Secured Creditors (Class 5) are to be paid out of their security, becoming unsecured creditors (Class 8) for any deficiency, with an express proviso against "an elevation or improvement of the status of a claim filed by any creditor in Class 5 as a result of the consolidation of the Debtors' Estates."

On May 20, 1971, the amended plan was approved by order, on findings substantially conforming to the trustee's representations.

On January 12, 1972, petitioner filed objections to confirmation of the amended plan, alleging that: It had filed a secured claim; it is the sole secured creditor in Class 5 and it did not accept the plan. By virtue of consolidation and under the dragnet clauses in the financing agreements, it is entitled to treat the properties of the two debtors "as one and indistinguishable and apply the Apco surplus against Continental's deficiency." The amended plan "is discriminatory as to (petitioner), improperly denies it the

full realization of its security, to which it is entitled as a result of the consolidation, and hence not "fair and equitable" within the meaning of Section 221(2) of the Bankruptcy Act, and it fails to comply with the protective provisions of Section 216(7) of the Bankruptcy Act."

After a hearing, an order was entered on August 12, 1974, overruling petitioner's objections and confirming the plan. (A23) The Court of Appeals affirmed in a split decision (A1 and A9) [517 F.2d 997 and 1002 (2 Cir. 1975)] and denied rehearing and rehearing in banc. (A22 and A23)

Reasons for Granting the Writ

I.

The main question of power to differentiate secured from unsecured claims in a consolidation is "one really of first impression." (A6) In *Chemical Bank New York Trust Company* v. *Kheel*, 369 F.2d 845 (2 Cir. 1966), consolidation was ordered on application of the Government holding an unsecured priority claim against the parent corporation with insufficient assets to satisfy the claim. As a result of consolidation with affiliates having large assets, the Government was so far advantaged as to take practically the entire consolidated estate. The only differentiating fact is that the Government, unlike petitioner, did not have a consensual lien. The difference is more apparent than real. The treatment of the underlying claim is the issue. Security and priority relate only to the claim's rank. The other aspects of the two cases are exactly the same. The Government did not bargain for the assets of the affiliates. The creditors of the affiliates were disadvantaged. The majority refused to follow *Kheel* even on these aspects, which are inevitable consequences of every consolidation.

II.

The case is of exceptional importance. There is hardly a corporation, whether giant or one of modest size and resources, that does not have one or more subsidiaries or affiliates. As common are one-man or family corporations and other closely-knit groups operating as multiple corporate units. A recurring feature of corporate business is control and domination of subsidiaries and affiliates by parent corporations and of single or multiple corporations by their principal shareholders and managers.

Inadequate capitalization and cash resources inevitably require secured financing by banks and modern factors. Liens on all or most of corporate assets are no longer a novelty. When financial distress brings corporations into court, serious and complex questions arise in administration of multi-unit debtors whose intercompany dealings and indiscriminate treatment of assets and liabilities have blurred or erased corporate lines. The effect on both secured and unsecured creditors is substantial. The rights and interests involved are great. Reorganization courts, in consolidations, are regularly called upon to balance equities while preserving legal rights.

The problems in this case arise in Chapter XI arrangements and in Chapters I through VII straight bankruptcies as well as in Chapter X reorganizations. The complexity and frequency of the problems and the large interests they affect make this case one of exceptional importance in administration of the bankruptcy laws.

III.

(1) The majority's "only equitable rationale" (A18) is the assertion as a categorical fact: "petitioner's liens

were in no way diminished or lien property transferred by virtue of intercorporate dealings." (A7) There is no evidence and no finding of the crucial fact. (A18)

The decision below rests in significant part (A8) on the bankruptcy court's undisputed equitable power to allow, reconsider, disallow and subordinate claims and to adjudicate equities as between creditors. Bankruptcy Act, § 2a(2), 11 U.S.C. § 11a(2); *Pepper* v. *Litton,* 308 U.S. 295, 308 (1939); *Sampsell* v *.Imperial Paper & Color Corp.,* 313 U.S. 215, 219 (1941). In this case the power was exercised to exclude petitioner's claim from consolidation without the indispensable proof and finding that petitioner was guilty of any fraud or misconduct in relation to the debtors or creditors. (A17)

(2) Reorganization courts provide for exploration of equities to redress any unfairness or injustice to individual creditors resulting from consolidation. See *Stone* v. *Eacho,* 127 F.2d 384 (4th Cir.), *rehearing denied,* 128 F.2d 16, *cert. denied* 317 U.S. 635 (1942), where it was held at p. 290:

> "If there are equities in favor of any of the creditors which have not been sufficiently explored in the motion for consolidation and as to which they desire to be heard further, hearing can be afforded them in the consolidated proceeding."

Under *Stone* v. *Eacho,* provision for protection of equities has been made in the consolidation orders. *In re Miller-Wohl Company, Inc.* (S.D.N.Y., 1973), unreported; *In re Lyntex Corporation* (S.D.N.Y., 1974), unreported.

Generally, the equities protected relate to reliance upon the credit of the separate entities giving rise to the right of satisfaction out of the separate assets notwithstanding consolidation. In the "rare case", however, where the

intermingling of assets and liabilities is so pervasive that separation is impossible, exploration of equities is futile and consolidation is ordered "to reach a rough approximation of justice to some rather deny any to all." *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845, 847 (2 Cir. 1966). Judge Friendly, concurring, noted that preservation of equities is "conspicuously lacking here." p. 848.

Since in the case at bar, as in *Kheel,* separation is impossible, the particular equities of reliance apparently do not limit the consolidation power. But other equities are conceivable. In the instant case, as heretofore noted, the court itself suggested the equity of lien-diminution. Yet rehearing was denied in the face of petitioner's offer of proof, on the requested remand, that its lien on Apco stock owned by Continental and pledged to petitioner for a large loan was diminished, in fact destroyed, as a result of manipulation which brought about the demise of both debtors.

There is also the equity arising from the fact that "except for" petitioner's "large infusion of capital, there might be nothing at all for the unsecured creditors". (A17-18) There are (A16) and may be still other equities for petitioner and for others. None of them were explored (A17); no provision was made in the consolidation order or separately for special notice and hearing on equities that any creditor might wish to assert.

(3) To appreciate the remarkable oddity of the majority's reasoning to reach its result, recognition must be given, as the majority refused to do, to the major premise that the consolidation findings speak as of the pre-petition period when petitioner's transactions with the debtors were had under the financing agreements. The debtors' abuse of the corporate privilege at that time worked an implied merger of the debtors, their assets and liabilities.

Page v. *Arkansas Natural Gas Corp.*, 53 F.2d 27 (8 Cir.), *affirmed on other grounds*, 286 U.S. 269 (1932). Continental and Apco came into court as impliedly merged entities. The consolidation findings merely confirmed the then existing merger which made the debtors one and their assets and liabilities interchangeable. *Trustee's System Co. of Pennsylvania* v. *Payne*, 65 F.2d 103, 108 (3 Cir. 1933); *Fitzgerald* v. *Central Bank and Trust Company*, 257 F.2d 118, 121 (10 Cir. 1958). (A14-15)

Rejection of the major premise led the majority into inconsistencies and illogicalities: (a) In the absence of cross-collateralization provisions in the financing agreements, the debts of Continental are not the debts of Apco. (b) The dragnet clause in the Apco agreements did not cover the debts of Continental. (A4, A5) (c) Under the plan, petitioner will obtain what it bargained for. (A7-A8) (d) Petitoner may not be permitted to improve its position. (A7, A29) (e) Petitioner's interests are not materially and adversely "affected" by the plan within the meaning of the Bankruptcy Act, § 107, 11 U.S.C. § 507 and the "absolute priority" rule has been followed. *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) 6A *Collier, Bankruptcy* § 11.06 at 613 (14th ed. 1970). (A9)

The major premise of a pre-petition implied merger refutes every one of the majority's underpinnings for the conclusions reached. (a) Absence of cross-collateralization is irrelevant. It would be necessary only if the debtors had been separate, "in which event there would be no need for the consolidation." (A15-16) (b) In "legal effect" the debtors were one at commencement of the proceedings. The security agrements with each debtor contained the same dragnet clauses. Hence the agreements were "in legal effect one and the same." (A15) (c) Only if the debtors had

been in fact separate is it possible to say that the plan gives petitioner what it bargained for. Even though petitioner "may have dealt separately with each debtor and relied on the assets of each for its protection, without knowledge that in fact Continental and Apco were operating as a hopelessly entwined, single entity, the same can be said for probably most, if not all, of the unsecured creditors." (A17) (d) Such advantage as petitioner might obtain from consolidation accrues to many of the unsecured creditors. (A17) That is the natural consequence of consolidation. (e) Petitioner has an equitable lien on the Apco surplus for the Continental deficiency. (A19) Petitioner's interests are materially "affected" by the plan within the meaning of Bankruptcy Act, § 107, 11 U.S.C. § 507. The plan violates the "absolute priority" rule and Bankruptcy Act, § 216(7), 11 U.S.C. § 616(7). It is not "fair and equitable." Bankruptcy Act, § 221(2), 11 U.S.C. § 621(2).

Absence of findings, denial of opportunity to explore equities, employment of an untenable rationale, all result in a plainly erroneous judgment which is unfair and unjust to petitioner.

Conclusion

The principal issue in the judgment sought to be reviewed is of first impression in this court and important in the administration of the bankruptcy laws. The judgment is plainly erroneous. The petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Opinion of the United States Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Entered June 5, 1975

No. 542—September Term, 1974.

(Argued April 1, 1975 Decided June 5, 1975.)

Docket No. 74-2233

In the matter of

CONTINENTAL VENDING MACHINE CORP. and
CONTINENTAL APCO, INC.,
Debtors,

JAMES TALCOTT, INC.,
Appellant,

v.

IRVING L. WHARTON, Trustee,
Appellee.

Before:

ANDERSON, MANSFIELD and OAKES,
Circuit Judges.

Appeal by a secured creditor in a Chapter X bankruptcy proceeding, challenging an approved plan of reorganization which calls for the consolidation of the debts and assets of two related corporations but provides that no secured creditor's claims shall be elevated or improved

as a result of the consolidation. Appellant claims that the plan which was confirmed by the United States District Court for the Eastern District of New York, Jacob Mishler, *Chief Judge,* was not "fair and equitable" since it treats unsecured claims as consolidated and secured claims as not consolidated. Held, that the plan is fair and equitable since the absolute priority of the secured creditor to the specific assets pledged to it are preserved and that the Bankruptcy Act does not require a consolidation to be complete for all purposes.

J. Jacob Hahn, Hahn, Hessen, Margolis & Ryan (Julius J. Abeson, of counsel), New York, N.Y. *for Appellant.*

Charles Seligson, Weil, Gotshal & Manges, New York, N.Y. (Joseph Marcheso, General Counsel for Continental Vending Machine Corp., of counsel), *for Appellee.*

Amicus brief filed by the SEC, David Ferber, Solicitor, SEC (Marvin E. Jacob, Associate Regional Administrator, New York Regional Office, SEC).

Oakes, *Circuit Judge:*

This appeal is by a secured creditor, James Talcott, Inc. (Talcott), in a Chapter X bankruptcy proceeding, 11 U.S.C. § 501 *et seq.*, involving a parent corporation, Continental Vending Machine Corp. (Continental), and its subsidiary, Continental Apco, Inc. (Apco). Talcott objects to an approved amended plan of reorganization for the two corporations because, while the plan calls for consolidation of the proceedings and treats the properties of the two debtors on the basis of a merger or consolidation of the two corporate entities, it provides that no secured creditor's claim shall be elevated or improved as a result of the consolidation. We are in short asked to determine whether it is "fair and equitable" under § 221 of the Bankruptcy Act (Act), 11 U.S.C. § 621, to disregard corporate lines and to consolidate or pool assets and liabilities for purposes of dealing with unsecured claims but not to do so for purposes of dealing with secured claims. We agree with the United States District Court for the Eastern District of New York, Jacob Mishler, *Chief Judge,* that the amended plan is "fair and equitable" since the absolute priority of Talcott to the specific assets pledged to it in connection with loans made to both the parent and subsidiary corporations has been preserved and that the Act does not require consolidation to be complete for all purposes. Accordingly, we affirm Judge Mishler's order approving the trustee's amended plan.[1]

Continental is a publicly owned Indiana corporation which at one time had a number of subsidiaries but for present purposes had only one of note, Apco, which it wholly owned. Apco was principally the sales arm for and Continental was the manufacturer of vending machines. Talcott financed each corporation, receiving mortgages of machines and other security devices from Continental covering its indebtedness, and assignments of accounts receiv-

[1] As a statutory party, 11 U.S.C. §§ 572-73, 608, the Securities and Exchange Commission participated in the action below and supports the judgment.

able and assorted other liens from Apco covering its indebtedness. The security agreements with each contained no cross-collateralization agreement, *i.e.*, no provision allowing Talcott to set off the obligations of one corporation against the collateral which it held to secure the debts of the related corporation, nor was there any guaranty by either Apco or Continental of the other's indebtedness. While the exact amounts are not yet ascertained, it appears that the liquidation of Talcott's security in Apco will leave at least a $380,000 surplus while the sale of the Continental security will result in a $820,000 deficit. Talcott, needless to say, would like to see its Apco lien apply to secure the Continental deficit. We point out that there is no evidence in the record that there were any intercompany transfers to the detriment of secured creditors, of which Talcott is now the only one remaining.

Appellant makes essentially two major points and a minor one. The first major one is that since improvement of some creditors' position is inherent in a consolidation it would be unfair and inequitable to permit the unsecured creditors to improve their position but to deny the secured creditor such improvement. The second major point is that the broad language of each of the security agreements giving Talcott a lien for "any and all obligations no matter how or when arising and whether under this or any agreement or otherwise . . ." applied to permit the Apco lien to cover the Continental deficit. The minor point, which was raised "with reservations," was that the plan was accepted by creditors holding 71.8 per cent of the total amount of claims filed and allowed. Appellant maintains that the amount required under § 179 of the Act, 11 U.S.C. § 579, is 75 per cent; that section, however, requires acceptance by creditors "holding two-thirds in amount" of the claims

filed and allowed as to each class, so that we fail to see any merit whatsoever to this argument. We take up the major points in reverse order.

Talcott had no lien on the Apco surplus for the Continental deficiency under any of its security agreements. The language of the Apco agreement, while broad, did not go so far as to cover the debts of Continental. There is nothing to indicate that the debt of Continental was the debt of Apco. It may be true that if the parties agree, the validity of a lien does not depend upon the existence of a contemporaneous debt. *In re Cichanowicz,* 226 F. Supp. 288 (E.D.N.Y. 1964) (secured notes paid down to zero, subsequent advances held covered by original security). But this does not mean that the Apco lien would somehow remain attached to Apco surplus after application of the Apco collateral to satisfy its debt to Talcott. On the contrary, once that Talcott debt was satisfied, no further lien on Apco property could exist, because the obligation of Apco was paid in full. As was stated in *United States* v. *Phillips,* 267 F.2d 374, 377 (5th Cir. 1959), "In the absence of an obligation to be secured there can be no lien."[2]

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[2] Appellant also argues that the "cram down" provisions of § 216(7) of the Act, 11 U.S.C. § 616(7), are applicable to the present case. This section of the Act sets out a procedure to be followed to effectuate the conformation of a reorganization plan even if the plan is not accepted by a class of creditors.

> A plan of reorganization under this chapter—
>
> . . . .
>
> (7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the

We turn then to the question, one really of first impression, whether differentiation of secured from unsecured creditors in a consolidation upon reorganization is proper under the Act.[3] The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation. *Soviero* v. *Franklin National Bank of Long Island,* 328 F.2d 446 (2d Cir. 1964); *In re Cintra Realty Corp.,* 413 F.2d 302 (2d Cir. 1969); *Stone* v. *Eacho* (*In re Tip Top Tailors, Inc.*), 127

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plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection. . . .

In the present case, however, this provision is inapplicable. As a secured creditor, Talcott is not "affected" by the amended plan within the meaning of the Act since its interests are not materially and adversely affected by the plan. As an *unsecured* creditor of Continental, Talcott is affected by the plan, but two-thirds of the class of unsecured creditors have accepted the plan and thus § 616(7) does not apply.

[3] There is no question that there is such differentiation under the amended plan. Article I thereof defines claims to include all claims against both Continental and Apco "which, except for the Claims of Secured Creditors, are treated herein on a consolidated basis." Article II provides that their properties will be dealt with "on the basis of a merger or consolidation thereof, without prejudice to the rights of Secured Creditors with respect to specific collateral securing indebtedness." Article IV, after providing that to the extent a secured creditor's claims are not satisfied by the sale of specific lien property the creditor is treated as an unsecured creditor, expressly precludes "elevation or improvement of the status" of a secured creditor's claim "as a result of the consolidation of the Debtor's Estates."

F.2d 284, 288-89 (4th Cir.), *rehearing denied,* 128 F.2d 16, *cert. denied,* 317 U.S. 635 (1942); *Hillebrand* v. *Sav-Co,* 353 F. Supp. 19, 21 (E.D. Ill. 1972). While it does not require that the creditors knowingly deal with the corporations as a unit, *Chemical Bank New York Trust Co.* v. *Kheel,* 369 F.2d 845, 847 (2d Cir. 1966), it should nevertheless be "used sparingly" because of the possibility of unfair treatment of creditors who have dealt solely with the corporation having a surplus as opposed to those who have dealt with the related entities with deficiencies. *Id.*

Appellant argues that what is sauce for the goose is sauce for the gander; it would, however, swallow the sauce by improving its status from that of a now unsecured creditor of Continental to that of a secured creditor of Apco. It cites *Chemical Bank, supra,* as requiring this improvement or elevation, since there the consolidation that was ordered benefited the United States as a tax lienor. But *Chemical Bank* did not deal with consensual liens as here; it dealt with the statutory priority. Nothing in *Chemical Bank* suggests that the priority of the United States rested on a lien which attached to the consolidated assets; rather, combining the assets of the related companies simply made more money available for the estate, as to which, to be sure, there was a substantial priority claim. In *Chemical Bank* there was, moreover, every reason to believe that the Government as an unsecured creditor had, along with other unsecured creditors, suffered loss because of the indiscriminate shifting of assets between corporations. Here, as a secured creditor in both parent and subsidiary, Talcott's liens were in no way diminished or lien property transferred by virtue of intercorporate dealings. In the end, Talcott will obtain under

the amended plan exactly what it bargained for with each in terms of security.

We have made it very plain that because consolidation in bankruptcy is "a measure vitally affecting substantive rights," the inequities it involves must be heavily outweighed by practical considerations such as the accounting difficulties (and expense) which may occur where the interrelationships of the corporate group are highly complex, or perhaps untraceable. *See In re Flora Mir Candy Corp.*, 432 F.2d 1060, 1062-63 (2d Cir. 1970). Thus, there is nothing to say for the proposition that in the exercise of the bankruptcy court's equity powers, *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 240 (1934), it cannot treat unsecured claims as consolidated and secured claims as not. *See In re Pittsburgh Railways Co.*, 155 F.2d 477, 484 (3d Cir.), *cert. denied*, 329 U.S. 731 (1946). Nor is there anything in the Act itself requiring the symmetry on which appellant insists. As we have pointed out, note 2 *supra*, as a secured creditor of Apco, Talcott is not "affected" by the amended plan within the meaning of § 107 of the Bankruptcy Act, 11 U.S.C. § 507, because its interests are not materially or adversely affected by the plan. In the allowance or disallowance of claims, the court has the equitable power under § 2(a)(2) of the Act, 11 U.S.C. § 11(a)(2), to make certain that injustice or unfairness does not occur. *Pepper* v. *Litton*, 308 U.S. 295, 308 (1939). Again, "The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete." *Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941). *See also Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946) (disallowing interest on interest as inequitable).

Finally it is suggested that the "absolute priority" rule, *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), requires that Talcott, as a secured creditor of Continental, also be treated as a secured creditor of Apco to the extent of the Apco surplus. We recognize that that rule makes a reorganization plan fair and equitable if and only if it provides participation for claims and interests in complete recognition of their strict priorities. 6A Collier, Bankruptcy ¶ 11.06 at 613 (14th ed. 1970). But, as we have said, Talcott is obtaining under the amended plan exactly what it bargained for: secured creditor status to the extent that its collateral was adequate. As to the balance of its claim it participates as an unsecured creditor with all the rights of such to the consolidated assets, *i.e.*, it is entitled to go against the Apco surplus as an unsecured creditor of Continental, along with all other unsecured group creditors. The absolute priority rule, as we see it, has therefore been followed.

Judgment affirmed.

ANDERSON, *Circuit Judge*, dissenting:

The majority holds that it is "fair and equitable" under § 221 of the Bankruptcy Act (Act), 11 U.S.C. § 621, to disregard corporate lines and to consolidate or pool assets and liabilities for purposes of dealing with unsecured claims but not to do so for purposes of dealing with secured claims. On the basis of the facts before the court, I respectfully dissent.

James Talcott, Inc. (Talcott), the appellant, was the principal financier or "factor" [1] for both Continental Vending Machine Corp. (Continental), a manufacturer of vending machines, and for Continental Apco, Inc. (Apco), a Continental sales subsidiary. Although Talcott received mortgages on vending machines and other security devices from Continental covering its indebtedness, and assignments of accounts receivable, chattel security devices and various other liens covering Apco's indebtedness, the written security agreements covering the obligations of Continental and Apco each contained a provision which provided, in relevant part:

> "You [i.e. Talcott] shall be entitled to hold all sums and all property of the undersigned, at any time to its credit or in your possession or upon or in which you may have a lien or security interest, as security for any and all obligations of the undersigned at any time owing to you and/or to any company which may now or hereafter be your subsidiary, no matter how or when arising and whether under this or any agreement or otherwise, and including all obligations for purchases made by the undersigned from any other concern factored by you or such subsidiary."

As noted by the majority opinion, however, neither security agreement contained a cross-collateralization provision,

[1] The term "factor," while traditionally referring to a "sales agent who receives goods and sells them for a commission, having a possessor lien on such goods or their proceeds," today generally denotes "a person who lends or advances money on the security of inventory or accounts receivable." 68 *Am. Jur.* 2d *Secured Transactions*, § 133 (1973). Talcott was a factor of the second variety.

and neither Continental nor Apco formally guaranteed the other's indebtedness.

On April 8, 1963, a conservator was appointed for Continental on the application of the Securities and Exchange Commission. An involuntary petition in bankruptcy was filed on July 5, 1963, but this proceeding was superseded when involuntary petitions for reorganization were filed on July 10, 1963 and October 4, 1963, under Chapter X of the Bankruptcy Act with respect to Continental and Apco, respectively.

Upon commencement of the conservatorship for Continental and successive reorganization proceedings of Continental and Apco, Talcott began and thereafter continued liquidation of its security, which, as noted in the majority opinion, left a surplus of approximately $380,000 in the Apco account and a deficiency of approximately $820,000 in the Continental account. Talcott also made numerous loans during this period to the conservator and to the trustee, secured by trustee's certificates, none of which had been repaid by the time this appeal was commenced.

Although as early as 1964, Talcott's counsel advised the trustee that there would probably have to be a consolidation of the two proceedings, it was not until June 13, 1969, when the trustee filed his report pursuant to § 167(5) of the Act, that he proposed such a consolidation. Thereafter, on June 20, 1969, he filed a consolidated plan of reorganization. About a year later, after several hearings on the proposed reorganization plan, an amended plan of reorganization was filed on June 15, 1970, which contained the proviso "Anything herein contained to the contrary notwithstanding, nothing in the Plan shall be, or be deemed to be an elevation or improvement of the status of a claim filed by

any creditor in Class 5 [secured creditors] as a result of the consolidation of the Debtors' Estates." On May 20, 1971, an order, with findings, was entered approving the amended plan, but on January 14, 1972, Talcott filed objections to its confirmation. Although a hearing was held on January 21, 1972, an order overruling Talcott's objections and confirming the amended plan was not entered until August 12, 1974—over two and one-half years later. This appeal followed.

In refutation of Talcott's argument that the broad language of its security agreements permits its lien on the Apco surplus to cover the Continental deficit upon consolidation of the debts and assets of Apco and Continental, the majority holds that Talcott did not possess a valid lien on the Apco surplus at the time the consolidation was approved because, as a result of Talcott's prior liquidation of the Apco collateral the obligation of Apco had been paid in full. Although *In re Cichanowicz,* 226 F. Supp. 288 (E.D.N.Y. 1964), stands for the proposition that under New York law a mortgage or other security agreement providing for future advances does not cease to exist merely because all earlier advances have been completely paid off (see G. Gilmore, *Security Interests In Personal Property,* Vol. II, § 35.3, at 924, n. 8 (1965)), the security agreement remains in existence only as to future advances of the "same class as the primary obligation . . . and so related to it that the consent of the debtor to its inclusion may be inferred." *National Bank of Eastern Arkansas* v. *Blankenship,* 177 F. Supp. 667, 673 (E.D. Ark. 1959), *aff'd sub nom National Bank of Eastern Arkansas* v. *General Mills, Inc.,* 283 F.2d 574 (8 Cir. 1960). See also G. Gilmore, *Security Interests In Personal Property,* Vol.

II, § 35.2 at 920; § 35.3 at 924-925; § 33.5 at 932 (1965). Any surplus remaining after the security of the defaulting debtor has been liquidated to satisfy the debt is, at least in the absence of an explicit agreement by debtor and creditor to the contrary, clearly not of the same class as the periodic future advances to a non-defaulting debtor contemplated under the typical inventory financing or receivables financing agreement.

If the validity of Talcott's claim necessarily depended upon the continued existence of a consensual lien on the Apco surplus uuder the broad provisions of Talcott's security agreement once the collateral had been liquidated, as assumed by the court below and as argued by the trustee on appeal, I would be in complete agreement with the majority's holding. As the majority opinion recognizes, however, there still remains the broader question whether differentiation between secured and unsecured creditors in a consolidation upon reorganization is proper under the Act. Under the circumstances present in this case, I believe that question must be answered in the negative.

In his June 13, 1969 report, filed pursuant to § 167(5) of the Bankruptcy Act, the trustee made the following statement based upon his investigation of the affairs of the two debtors:

> "It is clear that the debtors were operated as a single economic unit with little or no attention paid to the needs of Apco or to Continental's other subsidiaries. Any plan of reorganization which is proposed for said debtors should provide for a merger of the assets and liabilities of the debtors and consolidation of the within proceedings."

Accordingly, in the plan of reorganization, filed June 20, 1969, the trustee proposed that "All Properties of Continental, Apco, Coast Automatic Vending Corp., Continental Apco of Canada, Ltd., and any of their subsidiary or affiliated corporations and their Trustee . . . be dealt with by the Plan, on the basis of a merger or consolidation thereof." The trustee also stated:

> "The bases for applicant's recommendation [that any plan of reorganization should provide for a merger of the assets and liabilities of the debtors and a consolidation of the within proceedings] are that . . . , (e) there were guarantees and cross-guarantees of each other's obligations by the debtors which, in addition to the complex pattern of borrowing transactions between the debtors, makes the task of separating the assets and liabilities of the debtors virtually impossible; (f) there is little, if any, likelihood that an attempt to reconstruct all or a substantial portion of the financial transactions which occurred between the debtors would be successful; and, the cost of such an attempt might well exceed $1,000,000; and (g) no assurance can be given that such a division could be accomplished, regardless of the amount of money, time and effort which might be expended in such an attempt."

These findings were not changed in the amended plan.

It is clear from the foregoing that the instant consolidation merely confirmed an implied merger of the two debtors which pre-dated the filing of the involuntary reorganization petitions. See *Page* v. *Arkansas Natural Gas*

Corporation, 53 F.2d 27 (8 Cir. 1931), *aff'd on other grounds*, 286 U.S. 269 (1932). Because in legal effect Continental and Apco were one, prior to the initiation of these proceedings, and Talcott's security agreement with each contained the same broad dragnet clause, it follows that at the time the involuntary reorganization petitions were filed, Talcott's security agreements with Continental and Apco were in legal effect, one and the same.[2] See *Trustees System Co. of Pennsylvania* v. *Payne*, 65 F.2d 103 (3 Cir. 1933), in which the court held that the plaintiffs, as creditors of the parent corporation, had the equitable right to move for ancillary receivers of five subsidiary corporations which had not in fact maintained identities truly separate from the parent, because their character as creditors of the parent corporation extended to all the corporate departments or agencies it embraced; *Fitzgerald* v. *The Central Bank & Trust Company*, 257 F.2d 118 (10 Cir. 1958), in which a secured claim of a bank, which had lent money under a chattel mortgage to the president of a corporation doing business in his separate legal identity as the corporation's sales company, was treated as the debt of both the corporation and the sales company.

The absence of a cross-collateralization provision in Talcott's security agreements is, therefore, irrelevant. Such a provision would only have been necessary if Continental and Apco had, in fact, been two separate and independent

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[2] Talcott is not contending, of course, that a creditor secured solely by an identifiable piece of property belonging to one of the debtors could improve his secured position by consolidation. It is the breadth of Talcott's dragnet clause and its inclusion in identical form in each agreement, which necessitates different treatment.

corporations, in which event there would be no need for the consolidation contemplated here, similar to that approved in *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2 Cir. 1966).[3]

Equitable considerations also prompt me to note that had the trustee proposed a consolidated plan of reorganization *prior* to Talcott's liquidation of its Apco collateral,[4] he could not have maintained that Talcott did not have a valid lien on the Apco collateral then in Talcott's possession, and could not treat the debts of the two ostensibly independent corporations as one. It is hardly equitable now to hold that because the trustee took five years and the court took an additional five years to confirm that Continental and Apco had long been operated as a single economic entity, Talcott's claim can now be defeated, because meanwhile it had liquidated its collateral.

The majority, however, takes pains to point out that the court's power to consolidate is one arising out of equity; that it has the authority under § 2(a)(2) of the Act to insure that injustice is avoided; and that it can subordinate

[3] The court in *Kheel,* when discussing the necessity for substantive consolidation based upon the hopelessly intertwined dealings of the debtors gave no indication that such consolidation was to be used solely for the benefit of unsecured creditors. Similarly, *Kheel,* did not distinguish between secured and unsecured creditors when acknowledging the possible unfairness of consolidation to creditors who dealt solely with, or relied wholly on the assets of, one of the debtors to be consolidated. While that question was not directly before the court, it was obvious that unsecured, as well as secured creditors, could so rely.

[4] Cf. *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2 Cir. 1966), in which consolidation was approved pursuant to a motion by the United States, a major creditor, prior to the preparation and submission of a plan of liquidation.

claims or adjudicate equities which have as their bases the relationships among the creditors. Thus, the majority concludes that in the exercise of the bankruptcy court's equity powers it can treat unsecured claims as consolidated and secured claims as not. I agree, but the majority has failed to demonstrate that equitable considerations justify this result in the instant case. In fact, the equities are in favor of Talcott as previously discussed; and there are no countervailing inequities for which it has been responsible. There is no indication that Talcott is guilty of any fraud or wrongdoing with respect to Continental, Apco, or any of the other creditors in these proceedings. Even though Talcott may have dealt separately with each debtor and relied on the assets of each for its protection, without knowledge that in fact Continental and Apco were operating as a hopelessly entwined, single entity, the same can be said for probably most, if not all, of the unsecured creditors. The relative equities of relying creditors versus non-relying creditors, secured and unsecured, were not explored below, and the whole thrust of *Kheel* is that in the "rare case" such as this, where the hopelessly confused interrelationships cannot be unscrambled without large expenditures of time and money, and even then with no assurance of success, the court may order consolidation "to reach a rough approximation of justice to some rather than deny any to all." *Chemical Bank New York Trust Company* v. *Kheel, supra,* at 847. Although Talcott might secure an advantage through consolidation that it otherwise would not have had, likewise an advantage accrues, solely because of the consolidation, to many of the unsecured creditors who otherwise would not have had it. Moreover, ex-

cept for Talcott's large infusions of capital, there might now be nothing at all for the unsecured creditors.

The only equitable rationale put forward by the majority for distinguishing between secured and unsecured creditors in this case is the assertion that "Talcott's liens were in no way diminished or lien property transferred by virtue of intercorporate dealings." But there is no supporting evidence in the record and no finding to this effect in Judge Mishler's order conforming the trustee's amended plan of reorganization. Moreover, as noted by the court in *Kheel* and by the trustee in the instant case, consolidation was properly ordered in this case because it was virtually impossible to reconstruct intercorporate claims, transactions, liabilities and ownership of assets. For these very same reasons Talcott would undoubtedly find it equally impossible to demonstrate that its liens were diminished or lien property transferred even if it occurred. It certainly cannot be asserted with assurance, however, that money loaned by Talcott to Continental, and ostensibly secured, was not in fact turned over to Apco thereby creating the Continental "deficiency." It seems to me that the assumption underlying the type of consolidation present here and in *Kheel* is that the indiscriminate manipulation of the debtors was so extensive that neither the trustee nor the bankruptcy court could begin to sort out how each creditor or even classes of creditors were affected, and that *all* must have suffered, absent proof to the contrary. There is no such contrary proof here.

For the foregoing reasons, I would hold that Talcott had an equitable lien [5] on all the Apco collateral, including that now determined to be a "surplus," dating at the very least from the commencement of the reorganization proceedings. This lien was not dissipated by Talcott's liquidation of its Apco collateral, and permits Talcott, upon consolidation, to treat the debts of Continental as the debts of Apco under its security agreements, and to apply the so-called Apco "surplus" to the Continental deficiency. Accordingly, I would reverse.

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[5] The lien here invoked is the kind which the chancellor creates to do equity under the peculiar circumstances of the case, and, in particular, by the bankruptcy chancellor to implement a just reorganization. It can be described as a right, not existing at law, to have specific property applied in whole or in part to the payment of a particular debt and is based on general considerations of right and justice as applied to the relationship of the parties in the instant dispute. See generally, 51 *Am. Jur.* 2d *Liens* §§ 22-25 (1970).

APPENDIX B
Judgment of the United States Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
Entered June 5, 1975
74-2233

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifth day of June, one thousand nine hundred and seventy-five.

Present:

HON. ROBERT P. ANDERSON,
HON. WALTER R. MANSFIELD,
HON. JAMES L. OAKES,
Circuit Judges.

CONTINENTAL VENDING MACHINE CORP. and
CONTINENTAL APCO, INC.,
Debtors,

JAMES TALCOTT, INC.,
Appellant,

IRVING L. WHARTON, Trustee,
Appellee.

Appeal from the United States District Court for the Eastern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Eastern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed with costs to be taxed against the appellant.

A. DANIEL FUSARO
Clerk

By VINCENT A. CARLIN
Chief Deputy Clerk

APPENDIX C
Order Denying Petition for Rehearing in the United States Court of Appeals

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT
Entered September 16, 1975
74-2233

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixteenth day of September, one thousand nine hundred and seventy-five.

Present:

HON. ROBERT P. ANDERSON,
HON. WALTER R. MANSFIELD,
HON. JAMES L. OAKES,
Circuit Judges.

CONTINENTAL VENDING MACHINE CORP. &
CONTINENTAL APCO, INC.,
Debtors,

JAMES TALCOTT, INC.,
Appellant,

IRVING L. WHARTON, Trustee,
Appellee.

A petition for a rehearing having been filed herein by counsel for the appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. Daniel Fusaro
A. DANIEL FUSARO, *Clerk.*

APPENDIX D

Order Denying Petition for Rehearing In Banc in the United States Court of Appeals

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Entered September 16, 1975

74-2233

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixteenth day of September, one thousand nine hundred and seventy-five.

CONTINENTAL VENDING MACHINE CORP. & CONTINENTAL APCO, INC.,

Debtors,

JAMES TALCOTT, INC.,

Appellant,

IRVING L. WHARTON, TRUSTEE,

Appellee.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellant, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

Irving R. Kaufman

IRVING R. KAUFMAN, *Chief Judge*

APPENDIX E

Order Confirming Amended Plan

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF NEW YORK

Entered August 12, 1974

No. 63-B-663

In the Matter of

CONTINENTAL VENDING MACHINE CORP.,

Debtor.

No. 63-B-959

In the Matter of

CONTINENTAL APCO INC.,

Debtor.

On June 23, 1969, the Reorganization Trustee filed a consolidated Plan of Reorganization for Continental Vending Machine Corp. (Continental) and Continental Apco (Apco). Subsequently, the plan was amended and, by order dated May 20, 1971, the amended plan was approved by the Court and submitted to the creditors and stockholders for their consideration. A hearing on the confirmation of the plan was held on January 21, 1972. Talcott, a secured creditor of Continental and Apco, has filed an objection to the amended plan on the grounds that (1) the amended plan violates the provisions of § 216(7) of the Bankruptcy Act, 11 U.S.C. § 616(7), and (2) the

amended plan is not fair and equitable to Talcott within the meaning of §221(2) of the Act, 11 U.S.C. § 621(2).

Section 221 of the Act provides as follows:

The judge shall confirm a plan if satisfied that—

(1) the provisions of subchapter VII, section 599, and subchapter X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this title;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy.

Talcott argues that the amended plan does not comply with the provisions of § 216 of the Act (Art. 10, Subch. X),

11 U.S.C. § 616, and thus fails to satisfy the first condition of § 221. Section 216 provides in relevant part that:

A plan of reorganization under this chapter—

• • •

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

Talcott asserts that (1) it is a secured creditor of Apco, (2) it is "affected" by the plan[1], (3) as the only member of the class of secured creditors, it does not accept the plan, and (4) the plan fails to provide adequate protection for its security interest.

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[1] Section 107 of the Bankruptcy Act, 11 U.S.C. § 507, defines creditors who are affected by a reorganization plan as follows:

> Creditors or stockholders or any class thereof shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor or stockholder or class is so affected.

Talcott's argument, as the Trustee points out, is based on the false premise that it holds a security interest in the Apco surplus which is rendered enforceable by consolidation. (Trustee's Memorandum at 28). Talcott contends that at the time of the filing of the Chapter X petition, it held a valid secured lien on the Apco property in its possession. Post-petition liquidation of Talcott's security resulted in full satisfaction of Talcott's claim against Apco and produced a $380,000 surplus. Under the broad language of the security agreement,[2] Talcott asserts, it retained a continuing secured lien on this surplus "[u]ntil and unless Talcott should have become satisfied beyond any peradventure of the exhaustion of the remotest possibility of some yet undiscovered obligation subject to the lien, and until a final striking of the balances in its numerous accounts with the debtors. . . ." (Talcott's Reply Memorandum at 4). Upon consolidation, the liabilities of Apco and Continental would be merged, thereby entitling Talcott to apply its Apco lien against the $820,000 Continental deficiency.

The absence for a period of time of an underlying debt did not, Talcott contends, in any way impair its lien. Citing *In re Cichanowicz*, 226 F.Supp. 288, 291 (E.D.N.Y. 1964), Talcott argues that the "validity of a lien does not depend

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[2] Talcott's security agreements with Continental and with Apco contained the following identical provisions:

> You shall be entitled to hold all sums and all property of the undersigned, at any time to its credit or in your possession or upon or in which you may have a lien or security interest, as security for any and all obligations of the undersigned at any time owing to you and/or to any company which may now or hereafter be your subsidiary, no matter how or when arising and whether under this or any agreement or otherwise, and including all obligations for purchases made by you or such subsidiary.

upon the existence of a contemporaneous debt, if the parties so agreed." (Talcott's Reply Memorandum at 5). *Cichanowicz* simply stands for the proposition that a mortgage can be revived to secure debts incurred after the original indebtedness is discharged if the parties expressly or impliedly agree on this result. The court finds no authority in *Cichanowicz* for imposing a lien on surplus remaining after the application of collateral to a secured debt. The security agreement between Talcott and Apco, although broad, cannot be interpreted as creating such a lien. Moreover, Talcott's position is contrary to the long-established, basic principle that "[i]n the absence of an obligation to be secured there can be no lien." *United States* v. *Phillips*, 267 F.2d 374, 377 (5th Cir. 1959). In *Phillips*, the court clearly stated the applicable rule as follows:

> A lien is a charge upon property for the payment or discharge of a debt. It is therefore dependent upon the existence, the amount of, and the provability of the debt. If the debt has been paid or otherwise expunged as for fraud or by set-off, the lien is extinguished.

Id. at 376-77.

The court finds, therefore, that Talcott is simply an unsecured creditor as to the Continental deficiency, and that, as such, his rights are fully protected by the consolidation plan.

Talcott also challenges the amended plan on the ground that it is unfair and inequitable and therefore violates § 221(2) of the Act. Citing *Chemical Bank New York* v. *Kheel*, 369 F.2d 845 (2d Cir. 1966), Talcott argues that as a "necessary consequence" of consolidation, it had the

right to apply the Apco surplus againts the Continental deficiency and that the amended plan, by limiting secured creditors to "specific collateral securing specific indebtedness," deprived it of that right.

Here again, Talcott's argument is premised upon the existence of a valid security interest in the Apco surplus. As discussed above, such a premise is unsupported by either accepted rules of law or by the terms of the security agreement itself. Moreover, Talcott's reliance on *Kheel* is misplaced. In *Kheel,* Chemical Bank, a secured creditor of one of the bankrupt corporations, opposed a motion by the United States to consolidate chapter X proceedings with respect to eight corporations owned and controlled by one Kulukundis.

The court approved the consolidation, but cautioned that:

> The power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others. Yet in the rare case such as this, where the interrelationships of the group are hopelessly obscured and the time and expense necessary even to attempt to unscramble them so substantial as to threaten the realization of any net assets for all the creditors, equity is not helpless to reach a rough approximation of justice to some rather than deny any to all.

369 F.2d at 847. Judge Friendly, while concurring with the result reached by the majority, noted in a separate opinion his misgivings as to the elevated status which consolidation would confer on the Government's statutory lien:

> Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite, and the argument for equality has a specially hollow ring when made by the United States whose priority over other creditors will necessarily be enhanced by having the assets of all these corporations thrown into hotchpot.

369 F.2d at 848.

In the instant case, Talcott, as a secured creditor of Continental, received exactly the treatment for which it bargained. To allow Talcott to apply the Apco surplus to the remaining Continental deficiency through the fictional secured creditor status which Talcott now advances would be to give it considerably more than what it bargained for, to the prejudice and detriment of the other unsecured creditors. If there were no consolidation, Talcott would clearly be an unsecured creditor of Continental as to the amount owing after liquidation of its security. Consolidation under the amended plan will leave Talcott as an unsecured creditor as to the Continental deficiency. Accordingly, the court finds that the amended plan is "fair and equitable" and satisfies the condition imposed by § 221(2) of the Act.

Talcott's objections to the amended plan are overruled. The court is satisfied that the plan meets the requirements of § 221. The amended plan dated May 20, 1971 is confirmed and it is

So Ordered.

Jacob Mishler
U.S.D.J.

Supreme Court, U. S.
FILED
JAN 28 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-838

In re CONTINENTAL VENDING MACHINE CORP. and CONTINENTAL APCO, INC.,

Debtors.

JAMES TALCOTT, INC.,

Petitioner,

—v.—

IRVING L. WHARTON, as Trustee,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

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January 28, 1976

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

Opinions Below

James Talcott, Inc., the petitioner herein, seeks the issuance of a writ of certiorari to the United States Court of Appeals for the Second Circuit (the "Second Circuit") from the order of judgment and opinion issued June 5, 1975 by the Second Circuit (Appendixes A and B to the Petition at A1-A20). The judgment of the Second Circuit affirmed an order of the United States District Court for the Eastern District of New York (the "District Court") entered

August 12, 1974 (Appendix E to the Petition at A23-A29). The August 12, 1974 order of the District Court confirmed the Amended Plan of Reorganization under Chapter X of the Bankruptcy Act, 11 U.S.C. §501 *et seq.* for Continental Vending Machine Corp. ("Continental") and its subsidiary, Continental Apco, Inc. ("Apco") proposed by Irving L. Wharton, as Reorganization Trustee, the respondent herein, on June 15, 1970 (the "Amended Plan").

For the purpose of the treatment of unsecured creditors, the Amended Plan provides for the substantive consolidation of the assets and liabilities of Continental and Apco. Secured creditors are given only the specific collateral securing specific indebtedness under the Amended Plan, with an unsecured claim against the consolidated assets for the deficiency, if any. Petitioner, who holds security for its claims against Continental and Apco, objected to confirmation of the Amended Plan on the grounds that the Amended Plan violates the provisions of Section 221(2) of the Bankruptcy Act, 11 U.S.C. §621(2), and Section 216(7) of the Bankruptcy Act, 11 U.S.C. §616(7). The Second Circuit, in the majority opinion of Circuit Judge James L. Oakes, affirmed the District Court's opinion by the Honorable Jacob Mishler, Chief Judge, holding that the Amended Plan is fair and equitable since "the absolute priority of Talcott to the specific assets pledged to it • • • has been preserved," that the Bankruptcy Act "does not require consolidation to be complete for all purposes," and that the so-called "cram-down" provisions of §216(7) of the Bankruptcy Act are inapplicable in the present case.

Jurisdiction

The petition states that jurisdiction is invoked under 28 U.S.C. §1254(1). Although petitioner does not so state, respondent assumes that petitioner also invokes jurisdiction under Section 24(c) of the Bankruptcy Act, 11 U.S.C. §47(c).

Questions Presented

1. Whether the Second Circuit properly held that a reorganization plan which denies a secured creditor the right to elevate and improve its position, at the expense of unsecured creditors, as a result of a substantive consolidation of two debtors' assets and liabilities is nevertheless fair and equitable within the meaning of Section 221(2) of the Bankruptcy Act, 11 U.S.C. §621(2).

2. Whether the Second Circuit properly held that a reorganization plan premised on consolidation may deny a secured creditor the right to elevate and improve its position, at the expense of unsecured creditors, as a result of a substantive consolidation without complying with the so-called "cram-down" provisions of Section 216(7) of the Bankruptcy Act, 11 U.S.C. §616(7).

Statutes Involved

The pertinent provisions of Sections 107 and 221 of the Bankruptcy Act, 11 U.S.C. §§507 and 621, have been set forth in the Petition at pages 2-3. As to Section 216 of the Bankruptcy Act, 11 U.S.C. §616, petitioner has not set forth

at pages 2-3 of the Petition all sections deemed pertinent by respondent. Further there are certain textual errors in the sections set forth in the Petition and, therefore, respondent has deemed it necessary to set forth the relevant provisions of Section 216 at length below.

Section 216 of the Bankruptcy Act, 11 U.S.C. §616:

A plan of reorganization under this chapter—

(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

• • • • •

(6) shall specify the creditors or stockholders or any class of them not to be affected by the plan and the provisions, if any, with respect to them;

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by ap-

praisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

• • • • •

(14) may include any other appropriate provisions not inconsistent with the provisions of this chapter.

Statement of the Case

This litigation arises over the confirmation by the District Court of a plan of reorganization for Continental and Apco in their respective reorganization proceedings under Chapter X of the Bankruptcy Act, 11 U.S.C. §501 *et seq.* The reorganization plan in issue is the Amended Plan which was proposed by respondent herein.

Respondent filed the Amended Plan, in part, to assure that petitioner, and any other similarly situated secured creditor, would not obtain an elevated and improved security position as a result of the substantive consolidation of the assets and liabilities of Continental and Apco provided for under the Amended Plan. The order approving the filing of the Amended Plan also provided for consolidation of Continental and Apco. That consolidation will not, in fact, occur until such time as the Amended Plan is finally confirmed. Consolidation was ordered upon the findings, *inter alia,* that there were numerous transfers of funds in an extremely complex pattern between Continental and Apco which depended wholly upon Continental's needs, with little or no heed paid to the needs of Apco; books and records of Continental and Apco were not maintained in a

manner which would permit the accurate reconstruction of all or a substantial portion of the financial transactions between the debtors; and Apco was operated as a division or department of Continental and its business rather than as an independent corporate entity. No testimony or other evidence was introduced reflecting any intercompany transfers to the detriment of secured creditors, including petitioner.

The provisions of the Amended Plan relevant to the Petition are the following: Article I, *Definitions,* provides under the definition of "Claims" that all claims except the claims of secured creditors are to be treated on a consolidated basis. Article II, *Property to be Dealt With By the Plan,* states that all properties of the debtors will be dealt with on the basis of a merger or consolidation, "without prejudice to the rights of Secured Creditors with respect to specific collateral securing specific indebtedness." Article IV-B, *Provisions for the Payment of Secured and Certain Unsecured Creditors,* provides that payment is to be made to creditors in Class 5 (secured creditors) "to the extent that their Claims are secured by specific liens against Property of the Debtors [Continental and Apco] and the proceeds of the sale of such liened Property (the 'Proceeds') are sufficient to satisfy the particular Claims secured by such specific liens, • • • if sufficient Proceeds are not available, Creditors in Class 5 shall become Creditors in Class 7 [general unsecured claims of Senior Creditors] to the extent that their claims as creditors in Class 5 remain unsatisfied. • • • [N]othing in the Plan shall be, or be deemed to be, an elevation or improvement of the status of a Claim filed by any Creditor in Class 5 as a result of the consolidation of the Debtors' Estates."

The petitioner claims that it is the only member of Class 5, that it has not accepted the Amended Plan, and that the above-quoted provisions unfairly discriminate against it. In fact, there are a number of creditors of Continental and Apco who held security for the debts due them, all of whom, with the exception of petitioner, have now been paid, to the extent of the value of the collateral held, as a result of the liquidation of the collateral and many have filed unsecured claims for the balance due them. Petitioner, with the approval of respondent, has liquidated all of the collateral it was holding for advances made to Continental and Apco. After liquidation, petitioner has found that the value of the collateral it held for Continental's debts was less than the amount of the indebtedness due it from Continental; however, petitioner also has found that the value of the collateral it held for Apco's debts exceeded by a substantial margin the amount of the indebtedness of Apco to it. Petitioner continues to hold the proceeds it received from the liquidation of the collateral. Pursuant to an order of the reorganization court, petitioner was directed to file an accounting. The accounting, which is presently proceeding independently of petitioner's objection to confirmation and is not part of this petition, will result in fixing the exact amount of the Apco surplus and the Continental deficit. Petitioner has asserted that the Apco surplus is $380,000 and that the Continental deficit is $820,000. Respondent believes that the accounting will result in an increase of the amount of the Apco surplus, which surplus may be as much as $1,400,000. However, there is no doubt that the accounting will reflect a substantial dollar surplus in the Apco account and a substantial dollar deficit in the Continental account.

As stated in the Petition, petitioner holds both conservator's and trustee's certificates in a substantial amount, see Petition at 4-5. As of this date, certain of these certificates remain unpaid. It is respondent's position in the accounting proceeding referred to above that petitioner should have applied the Apco surplus to certain of the obligations of respondent evidenced by the certificates. Petitioner has asserted in that proceeding that it was not required to make such an application and that it may, instead, set off the Apco surplus against the Continental deficiency as a result of the consolidation. Although the payment of the certificates is part of the overall dispute between petitioner and respondent, the question is not before this court and does not affect the correctness of the Second Circuit's decision.

The indebtedness of Continental and Apco to petitioner is governed by separate, but similar, secured accounts receivable factoring agreements. Both of these agreements provided as follows:

> "You [i.e. petitioner] shall be entitled to hold all sums and all property of the undersigned [i.e., the borrowing corporation], at any time to its credit or in your possession or upon or in which you may have a lien or security interest, as security for any and all obligations of the undersigned at any time owing to you, and/or any company which may now or hereafter be your subsidiary, no matter how or when arising and whether under this or any other agreement or otherwise, and including all obligations for purchases made by the undersigned from any other concern factored by you or such subsidiaries."

Continental was not a party to, nor guarantor of, the security agreement between Apco and petitioner. Likewise, Apco was not a party to, nor a guarantor of, the security agreement between Continental and petitioner. Petition at 5. Thus, in the absence of consolidation, petitioner would not be entitled to apply the Apco surplus against the Continental deficit. Petitioner made numerous advances under both of these security agreements, in all instances taking collateral which it considered satisfactory and sufficient both in type and amount at the time of the advance. Among the collateral held by petitioner for the debt of Continental was the capital stock of Apco.

I

The Decision Below Clearly Is Correct.

a. *Consolidation Need Not Be Complete or For All Purposes.*

The decision of the Second Circuit overruling petitioner's objection to confirmation of the Amended Plan is plainly correct. As the Second Circuit held, the bankruptcy court, which is a court of equity, has the power to consolidate, enabling a bankruptcy court to disregard separate corporate entities. Appendix A to Petition at A6. Further, as the Second Circuit held,

> "In the allowance or disallowance of claims, the court has the equitable power under §2(a)(2) of the Act, 11 U.S.C. §11(a)(2), to make certain that injustice or unfairness does not occur. *Pepper* v. *Litton,* 308 U.S. 295, 308 (1939). Again, 'The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several

> creditors is complete.' *Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)." Appendix A to Petition at A8.

Petitioner concedes that the bankruptcy court has these fundamental equitable powers. Petition at 10.

Consolidation is an equitable doctrine. *Taylor* v. *Standard Gas & Electric Company,* 306 U.S. 307, 322 (1939). Therefore, it is peculiarly appropriate for application by the bankruptcy court, which sits as a court of equity. "[C]ourts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co.* v. *Hunt,* 292 U.S. 234, 240 (1934). Although consolidation may be premised on a state of facts occurring prior to the filing of the bankruptcy petition, no merger of the corporations at law ever takes place. Rather, in the context of the bankruptcy case, and for the purposes of it only, the court determines to pierce the corporate veil for a particular purpose, *Fitzgerald* v. *Central Bank and Trust Company,* 257 F.2d 118, 120 (10th Cir. 1958); *Hollander* v. *Henry,* 186 F.2d 582 (2d Cir. 1951); *Trustees System Co. of Pennsylvania* v. *Payne,* 65 F.2d 103, 107 (3d Cir. 1933) (equity receivership); *Hillebrand* v. *Sav-Co,* 353 F.Supp. 19 (E.D. Ill. 1972), or to treat the assets and liabilities of the corporations together, *In re Flora Mir Candy Corporation,* 432 F.2d 1060 (2d Cir. 1970); *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2d Cir. 1966); *Soviero* v. *Franklin National Bank of Long Island,* 328 F.2d 446 (2d Cir. 1964); *Stone* v. *Eacho,* 127 F.2d 284 (4th Cir.), *rehearing denied* 128 F.2d 16, *cert. denied* 317 U.S. 635 (1942).

The case of *Page* v. *Arkansas National Gas Corporation,* 53 F.2d 27 (8th Cir. 1931), cited by petitioner at pages 11 and 12 of the Petition, is clearly distinguishable and did not involve consolidation in a Chapter X case. The facts were as follows: A trustee in bankruptcy of an oil leaseholding trust conveyed title to a certain oil lease pursuant to court order. After substantial expenditures were made by the purchaser in getting the well into production, certain creditors asserted that the conveyance was ineffective as the trustee never had title to the lease. The court felt compelled, under these rather unique circumstances, to find an estoppel against the objecting creditors to deny the trustee's title and an implied merger under the terms of the trust instrument. The court resorted to the legal principle of piercing the corporate veil to prevent a windfall to the objectors who had been content to stand back and do nothing until after the purchaser made substantial expenditures. As *Page* and the cases cited above reflect, consolidation is ordered, or a corporate veil is pierced, to prevent fraud or injustice. The facts of this case are clearly distinguishable from *Page.*

It is well settled that a court of equity may recognize the corporate entity in some instances and disregard it in others as equity requires.

> "The effect of a grant of a corporate charter to a group of individuals is described in many ways in figurative language. Perhaps the favorite phrase is the 'corporate veil' which courts are supposed to pierce from time to time as circumstances require. We think a more accurate figure is that of a cloak which on some occasions is to be worn and on other occasions is to be stripped off. To talk legal effect instead of fanciful

> figures of speech, the corporate fiction can be given effect in some instances and with perfect consistency, disregarded in other instances." *In re Pittsburgh Rys. Co.,* 155 F.2d 477, 484 (3d Cir.), cert. den. 329 U.S. 731 (1946).

Accord, Corsicana National Bank v. *Johnson,* 251 U.S. 68, 88 (1919) and *Irving Trust Co.* v. *Kaminsky,* 22 F.Supp. 362, 363 (S.D.N.Y. 1937). The Second Circuit opinion recognizes this principle. Appendix A to Petition at A8.

The Amended Plan acknowledges that recognition of the separate corporate identities of Continental and Apco would be inequitable as to unsecured creditors because Apco was inadequately capitalized and funds were transferred from it depending wholly on Continental's needs. The Amended Plan also recognizes that failure to acknowledge the separate corporate entities as to secured creditors would give a windfall to secured creditors. Thus, the Amended Plan balances the equities between secured and unsecured creditors. However, petitioner asserts that it should be permitted to elevate and improve its security position under the Amended Plan and obtain the windfall benefit of cross-collateralization of the Apco surplus to the Continental deficiency, a right which it does not have under its security agreements.

Both the majority and the dissent in the Second Circuit decision in this case agree that consolidation need not be complete for all purposes. Appendix A to Petition at A8 (majority opinion) and at A16-A17 (dissenting opinion). As the Second Circuit correctly held, consolidation of Continental and Apco for the purpose of the Amended Plan does not preclude the court from determining that it is inequitable to permit petitioner to obtain a windfall of at least $380,000 and perhaps as much as $1,400,000. Equity looks through and beyond the form of a transaction to its substance. *White* v. *Cotzhausen,* 129 U.S. 329, 341 (1889); *Young* v. *Higbee Company,* 324 U.S. 204, 209 (1945); *In re Eilers Music House,* 270 Fed. 915, 924 (9th Cir. 1921). Equity can and should as in this case prevent its equitable remedy from conferring a windfall.

In assailing the decision of the Second Circuit, petitioner's major premise appears to be that there is a "pre-petition implied merger" when consolidation is ordered in a bankruptcy proceeding and that it was the majority's failure to recognize this fact which caused the Second Circuit to reach an erroneous result. Petition at 11-12. Petitioner contends that the consolidation findings "merely" confirm "the then existing merger which made the debtors one and their assets and liabilities interchangeable." Petition at 12. Respondent believes the authorities just discussed amply refute this argument by petitioner. If there was in fact a "pre-petition implied merger" every time consolidation is ordered, there could be no room for the exploration of equities in favor of a particular creditor, which exploration petitioner urges on this court. See *Stone* v. *Eacho,* 127 F.2d 284 (4th Cir.), *rehearing denied,* 128 F.2d 16, *cert. denied,* 317 U.S. 635 (1942).

Petitioner seeks to suggest several equities in its favor which purportedly were overlooked. The first is its loans to the conservator and to respondent.

> "There is also the equity arising from the fact that 'except for' petitioner's 'large infusion of capital, there might be nothing at all for the unsecured creditors.'" Petition at 11.

The record in these Chapter X cases demonstrates that those loans were, and are, interest-bearing and will be paid in full in these cases. The loans were made by petitioner presumably because petitioner thought the continuation of the businesses of Apco and Continental would assist the petitioner to realize the maximum amounts on the liquidation of its collateral. Nothing suggests that petitioner made these loans out of an altruistic concern for the unsecured creditors. Nor did petitioner bargain for, as consideration for such loans, the treatment it now seeks. None of the cases cited by petitioner suggest that a post-petition event can create an equity in favor of a pre-petitioner creditor to be considered on consolidation. Petitioner further ignores the fact that Chief Judge Mishler, who rendered the District Court opinion herein, was thoroughly familiar with and authorized petitioner's loans to respondent, as these Chapter X cases have been pending before him since 1963 and the District Court evidently did not view the loans as creating such an equity in favor of petitioner that they warranted a windfall of $380,000 or more.

Petitioner also suggests that somehow its liens were diminished or lien property transferred by way of intercorporate dealings and that this too is an unexplored equity in its favor. Petitioner makes much of its offer of proof on its petition for rehearing to the Second Circuit that its lien on the capital stock of Apco owned by Continental "was diminished, in fact destroyed, as a result of manipulation which brought about the demise of both debtors." Petition at 11. This claim is without merit. Chief Judge Mishler ruled on May 20, 1971 that both Continental and Apco are insolvent and that, therefore, stockholders of Continental and Apco "have no claims or interest of any value

in either of the debtors, and their rights are not affected by the Amended Plan." Petitioner's objection to confirmation fails to include any objection to the elimination of the stockholders' positions under the Amended Plan. Furthermore, generalized proof by petitioner that the principals of Continental and Apco ran these corporations into bankruptcy and thereby destroyed the value of the Apco and Continental stock could not elevate the stockholders' position under this court's holding in *Case* v. *Los Angeles Lumber Products Co.,* 308 U.S. 106 (1939) establishing the "absolute priority" rule in corporate reorganizations. See also, 6A *Collier on Bankruptcy* (14th Ed. 1972), ¶11.06, and discussion, *infra.*

Furthermore, petitioner's offer of proof comes too late. Petitioner was given a full and fair opportunity to litigate its claims. Petitioner was present at all hearings at which respondent introduced the evidence on which the consolidation was based and did not ask a *single* question of the witnesses or seek to introduce any evidence of its own. On January 21, 1972, at the hearing on confirmation of the Amended Plan and petitioner's objection thereto, petitioner did not seek to introduce any evidence in support of its position that the Amended Plan should not be confirmed as it was not "fair and equitable" despite full knowledge of respondent's position on the consolidation questions at issue. At no time was petitioner denied the right to introduce any evidence it desired. Petitioner chose to treat the matter solely as an issue of law and should not now be heard to complain that it should have been treated as a question of fact. In this one respect the instant case is very similar to the situation in *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2d Cir. 1966), in which

none of the persons objecting to consolidation offered any evidence. See the lower court's opinion in that case, *In re Seatrade Corporation,* 255 F.Supp. 696, 697 (S.D.N.Y. 1966). As Circuit Judge Friendly said in his concurring opinion in *Chemical Bank,* "the Government's proof of long continued intermingling of the affairs of the various • • • companies required the Chemical to come forward with at least something more." 369 F.2d at 848-849.

b. *The Amended Plan Is "Fair and Equitable".*

The Second Circuit's decision overruling petitioner's objection to confirmation of the Amended Plan is plainly correct. The Amended Plan is clearly "fair and equitable" within the meaning of Section 221 of the Bankruptcy Act, 11 U.S.C. §621, even though it denies petitioner the right to elevate and improve its position as a result of consolidation, as it accords to petitioner its rights as mandated by the "absolute priority" rule enunciated by this court in *Case* v. *Los Angeles Lumber Products Co.,* 308 U. S. 106 (1939).

> "It is • • • well settled that the words 'fair and equitable' incorporate the rule of absolute priority as between all classes of claimants and security holders; that full compensatory provisions must be made for the entire bundle of rights surrendered by a class; and that any plan which attempts to divert to a junior class values properly allocable to senior classes fails to meet the statutory standard." 6A *Collier on Bankruptcy* (14th Ed. 1972), ¶10.12 at 462.

See also the discussion in 6A *Collier on Bankruptcy* (14th Ed. 1972), ¶11.06; *SEC* v. *United States Realty and Improvement Company,* 310 U. S. 434 (1940); and *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510 (1941).

The Second Circuit carefully considered the application of the "absolute priority" rule in the instant case as its opinion reflects:

> "We recognize that • • • [the 'absolute priority'] rule makes a reorganization plan fair and equitable if and only if it provides participation for claims and interests in complete recognition of their strict priorities. 6A Collier, Bankruptcy ¶11.06 at 613 (14th Ed. 1970). But, as we have said, Talcott [the petitioner herein] is obtaining under the amended plan exactly what it bargained for: secured creditor status to the extent that its collateral was adequate. As to the balance of its claim it participates as an unsecured creditor with all the rights of such to the consolidated assets, *i.e.,* it is entitled to go against the Apco surplus as an unsecured creditor of Continental, along with all other unsecured group creditors. The absolute priority rule, as we see it, has therefore been followed." Appendix A to the Petition at A9.

As to the so-called "cram-down" provisions of Section 216(7) of the Bankruptcy Act, 11 U.S.C. §616(7), which petitioner also claims have been violated, the Second Circuit considered this issue so unimportant given its holding on the "fair and equitable" issue that it relegated the issue to a footnote. See Appendix A to Petition at A5-A6, footnote 2. Briefly, Section 216(7) contains certain provisions for the protection of a class of creditors "affected" by a reorganization plan when two-thirds of that class do not accept the plan. Section 107 of the Bankruptcy Act, 11

U.S.C. §507, provides that creditors are deemed to be "affected" by a plan only if their interests are materially and adversely affected thereby.

Under the Amended Plan proposed by respondent, all secured creditors are placed in Class 5; general unsecured claims of senior creditors in Class 7; and stockholders in Class 10; and Article X of the Amended Plan provides that only creditors in Classes 7, 8 and 9 are deemed to be affected. As a secured creditor, petitioner is not "affected" by the Amended Plan within the meaning of Section 107 of the Bankruptcy Act, 11 U.S.C. §607, as its interests are not materially and adversely affected by the Amended Plan as it receives the benefit of all of the specific collateral for which it bargained, but no more. As an unsecured senior creditor of Continental, petitioner is "affected" by the Amended Plan. However, more than two-thirds of the class of unsecured senior creditors who were entitled to vote on the Amended Plan have accepted the Amended Plan. Thus, the "cram-down" provisions are rendered inapplicable.

II

No Sound Reason Exists for the Granting of the Petition for Certiorari.

The decision of the Second Circuit with respect to which petitioner seeks the issuance of a writ of certiorari is the only reported decision of an appellate court on the precise questions involved herein. Petitioner relies heavily on the decision in *Chemical Bank New York Trust Company* v. *Kheel,* 369 F.2d 845 (2d Cir. 1966) and urges at page 8 of the Petition that in the instant case the Second Circuit refused to follow its earlier opinion in *Chemical Bank* even

on the aspects of the failure of the Government in *Chemical Bank* to bargain for the assets of the affiliates and the disadvantage to creditors of the affiliates by consolidation "which are inevitable consequences of every consolidation." The Second Circuit carefully considered petitioner's argument that the *Chemical Bank* decision mandated the result petitioner seeks in this case and held that

> "But *Chemical Bank* did not deal with consensual liens as here; it dealt with the statutory priority. Nothing in *Chemical Bank* suggests that the priority of the United States rested on a lien which attached to the consolidated assets; rather, combining the assets of the related companies simply made more money available for the estate, as to which, to be sure, there was a substantial priority claim." Appendix A to Petition at A7.

Although Circuit Judge Anderson discusses the *Chemical Bank* case in his dissenting opinion, at no point does he assert that the majority opinion is contrary to the holding of the earlier *Chemical Bank* decision. Indeed, he agrees with the majority that

> "[T]he court's power to consolidate is one arising out of equity; that it has the authority under §2(a)(2) of the Act to insure that injustice is avoided; and that it can subordinate claims or adjudicate equities which have as their bases the relationships among the creditors. *Thus, the majority concludes that in the exercise of the bankruptcy court's equity powers it can treat unsecured claims as consolidated and secured claims as not. I agree,* but the majority has failed to demonstrate that equitable considerations justify this result in the

instant case." Appendix A to Petition at A16-A17. (Emphasis added.)

Thus, the difference between the majority and the dissenting opinions is *not* as to the principles of law but merely as to the application of those agreed-upon principles of law to the facts of this case. As Justice Holmes wrote in *United States* v. *Johnston,* 268 U.S. 220, 227 (1925):

> "We do not grant a certiorari to review evidence and discuss specific facts."

Accord, Boehmer v. *Pennsylvania R.R. Co.,* 252 U.S. 496, 498 (1920) ("[T]he rule is well settled that [when the decision depends upon an appreciation of the particular facts presented] • • • where two courts have agreed we will not enter upon a minute analysis of the evidence.") That the majority's application of the law to the facts of this case does not shock the conscience and has not so far departed from the usual and accepted standards of judicial conduct is indicated by the failure of the Second Circuit to grant petitioner's motion for rehearing and the suggestion for rehearing en banc.

There is no conflict among the circuits on the issue presented here. As the Second Circuit said the question is one "really of first impression." Appendix A to Petition at A6. Further, to the extent that the Supreme Court has previously considered the general principles of law underlying the issues in this case, its decisions have been followed and are not in conflict with the decision of the Second Circuit. The Second Circuit relies on a number of important Supreme Court decisions in its opinion—*Pepper* v. *Litton,* 308 U.S. 295 (1939); *Case* v. *Los Angeles Lumber Products Co.,*

308 U.S. 106 (1939); *Sampsell* v. *Imperial Paper & Color Corp.,* 313 U.S. 215 (1941); and *Vanston Bondholders Protective Committee* v. *Green,* 329 U.S. 156 (1946). Appendix A to Petition at A8. Further, the Supreme Court recognized over fifty years ago that a corporation can be respected as a separate entity for some purposes but not for other purposes. *Corsicana National Bank* v. *Johnson,* 251 U.S. 68, 88 (1919).

Nor does the petition raise a significant question in the administration of the Bankruptcy Act, which has not, but ought to be decided by this court, such as was raised in *Reading Co.* v. *Brown,* 391 U.S. 471, 475 (1968) (Negligence claim against receiver as expense of administration). It is not a case of exceptional importance, as alleged in the Petition on page 9. As the Petition notes, many corporations have subsidiaries and affiliates. Not infrequently, the parent and the subsidiaries or affiliates operate as one large, interrelated business complex. It is also true that there are, and have been, a number of Chapter X and XI cases, as well as straight bankruptcies, in the lower courts encompassed within the Second Circuit involving such related entities. Consolidation has been sought and granted in some of these cases. Remarkably, however, the issue presented here has never before arisen. Respondent submits that the facts here are extremely unusual —a creditor of two related entities holds security for the indebtedness of each which, when liquidated, produces a substantial surplus as to one and a substantial deficit as to the other, *but the creditor has no cross-collateralization agreement or guaranty.* Much more common would be an oversecured position in both or an undersecured position in both and/or a guaranty or cross-collateralization agree-

ment. Thus, this court is being asked to resolve an issue which appears to be of academic interest except for the instant litigant. Respondent submits that it is highly unlikely that this situation will arise in the future as one can safely assume that the attorneys for secured lenders throughout the nation are even now redrafting and modifying their standard secured loan agreements and lending practices so as to protect themselves against the instant situation.

The petition herein is sought only for the particular benefit of petitioner and is not sought to settle any genuine conflict of opinion and authority. As Chief Justice Taft wrote in *Magnum Import Company* v. *Coty*, 262 U.S. 159, 163 (1923):

> "The jurisdiction to bring up cases by certiorari from the Circuit Court of Appeals was given for two purposes, first to secure uniformity of decision between those courts in the nine circuits, and second, to bring up cases involving questions of importance which it is in the public interest to have decided by this Court of last resort. The jurisdiction was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing."

Therefore, there exists no sound reason which would favor the issuance of a writ of certiorari to the Second Circuit.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 75-838

In the Supreme Court of the United States

OCTOBER TERM, 1975

JAMES TALCOTT, INC., PETITIONER

v.

IRVING L. WHARTON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The majority and dissenting opinions of the court of appeals (Pet. App. A) are reported at 517 F. 2d 997 and 1002. The opinion of the district court (Pet. App. E) is unreported.

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[1]The Securities and Exchange Commission has been participating in these reorganization proceedings in the district court as a party pursuant to Section 208 of Chapter X of the Bankruptcy Act, 11 U.S.C. 608, since shortly after the proceedings commenced in 1963. It has taken positions in that court and in the court of appeals similar to the positions urged herein. As in *Protective Committee* v. *Anderson*, 390 U.S. 414, 420 n. 3, and *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416, 419 n. 8, the Commission is "an unnamed respondent before this Court." See Rule 21(4) of the Rules of this Court.

JURISDICTION

The judgment of the court of appeals was entered on June 5, 1975 (Pet. App. B). Orders denying rehearing and rehearing *en banc* were entered on September 16, 1975 (Pet. App. C and Pet. App. D, respectively). The petition for a writ of certiorari was filed on December 15, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether under the circumstances of this case a plan of reorganization under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, which provided for the consolidation of the assets and liabilities of two debtors, one of which was wholly owned by the other, is not "fair and equitable" within the meaning of Section 221(2) of Chapter X of the Bankruptcy Act because it precluded a secured creditor of both corporations from applying surplus collateral of the subsidiary toward the secured creditor's insufficiently collateralized claim against the parent.

STATUTE INVOLVED

Section 221 of the Bankruptcy Act, as added, 52 Stat. 897, 11 U.S.C. 621, provides in pertinent part:

> The judge shall confirm a plan if satisfied that—
>
> (1) the provisions of article VII, section 199, and article X of this chapter have been complied with;
>
> (2) the plan is fair and equitable, and feasible;
>
> * * * * *

STATEMENT

Petitioner, James Talcott, Inc. ("Talcott"), a factor, was the principal financier of Continental Vending Corporation ("Continental") and its wholly-owned subsidiary, Continental Apco, Inc. ("Apco"). Talcott advanced funds to

each of the corporations under separate security agreements, which provided that the collateral pledged by each corporation would be security for all present and future obligations of that company. The agreements made no provision for cross-collateralization and the companies did not guarantee each other's debts to petitioner (Pet. App. A10-A11).

Involuntary petitions under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, were separately filed against Continental and Apco, and there is a single trustee for both debtors. The trustee proposed a plan of reorganization which provided for a merger of the assets and liabilities of the two corporations and a consolidation of the proceedings. The trustee stated, *inter alia*, that (i) the operations of Continental and Apco constituted a single economic enterprise; (ii) there were guarantees and cross-guarantees by the debtors of many of each other's obligations and a complex pattern of transfers of funds between Continental and Apco, which depended wholly on Continental's needs; and (iii) the task of separating the assets and liabilities of the debtors or of reconstructing the inter-company financial transactions was virtually impossible regardless of the time, money and effort expended (CA App. 25a-26a).[2] A subsequent amended plan of reorganization provided, additionally, that claims against the debtors, except for claims of secured creditors, were to be treated on a consolidated basis. With respect to claims of secured creditors, the plan contained an express proviso against an elevation or improvement of the status of such claims as a result of the consolidation (CA App. 36a-37a). On May 20, 1971, the amended plan was approved by order on findings substantially conforming to the trustee's representations (CA App. 40a-41a).

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[2] "CA App." refers to the appendix filed in the court of appeals, a copy of which has been lodged with the Court.

After hearing, the district court confirmed the amended plan. The court of appeals affirmed and denied rehearing and rehearing *en banc*.

ARGUMENT

The decision of the court of appeals is correct and is not in conflict with the decisions of this Court or of any other court of appeals. The petition presents primarily a factual issue that does not warrant further review.

Although normally a reorganization requires a determination of what assets are subject to the payment of the respective claims, see *Consolidated Rock Products Co.* v. *Du Bois,* 312 U.S. 510, 520,[3] occasionally the expense and difficulty of making the required determination make it necessary simply to consolidate the assets of the separate corporate entities involved. See *Stone* v. *Eacho,* 127 F. 2d 284, 289 (C.A. 4), rehearing denied, 128 F. 2d 16, certiorari denied, 317 U.S. 635. While this alternative is not frequently used, see *Chemical Bank New York Trust Co.* v. *Kheel,* 369 F. 2d 845, 847 (C.A. 2); *Anaconda Building Materials Co.* v. *Newland,* 336 F. 2d 625 (C.A. 9), because of the potential inequities that may result to certain creditors, petitioner does not challenge the court's authority to order consolidation, nor does it challenge the appropriateness of consolidation in this case. The contention rather is that the district court abused its discretion in determining that the consolidation was appropriate only as to the claims of unsecured creditors.[4]

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[3]This holding was in the context of a "unified operation" of a parent and two subsidiary corporations that resulted in a "commingling of assets." *Id.* at 519. This Court determined that the reorganization court should find "some appropriate formula for at least an approximate ascertainment of their respective assets" in order fairly to compensate the bondholders of the two subsidiaries. *Id.* at 525.

[4]In his dissenting opinion, Judge Anderson states his agreement with the legal principles applied by the majority (see Pet. App. A17) and also predicates his dissent solely on the application of those principles to the facts (Pet. App. A9, A12, A17).

But the court determined there was no need for this unusual relief as to the claims of secured creditors because, as the court of appeals found (Pet. App. A4), there was "no evidence in the record that there were any intercompany transfers to the detriment of secured creditors * * *." Absent such a showing, consolidation as to secured creditors might result in permitting creditors of the parent corporation (who realized a deficiency on their security) to have a priority as to assets of the subsidiary, to the detriment of the latter's general creditors.

Under these circumstances, it was not an abuse of discretion for the court to order consolidation only with respect to the claims of the unsecured creditors.[5] Petitioner, which had obtained no cross guarantees on its separate security agreements, should not be permitted to apply assets subject to a lien against one debtor to its lien against the other. Under the plan for liquidation, petitioner has been allowed to liquidate its security, and as an unsecured creditor will be able to make its claim (against the consolidated assets) for the deficiency. This is nothing less than "what [petitioner] bargained for * * *" (Pet. App. A8).[6]

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[5]None of the cases cited by petitioner holds that a merger or consolidation must be complete for all purposes. In *Kheel, supra,* relied on heavily by petitioner, the enhancement of the government's position as a creditor resulted from a statutory priority contained in the Bankruptcy Act, a congressional expression of policy. The effect of consolidation on the position of Talcott is not governed by any statutory prescription but solely by equitable considerations within the discretion of the bankruptcy court.

[6]If, for example, two related debtors each owned an office building and the same creditor held a separate mortgage on each of those buildings, it would be difficult to imagine circumstances where it would be equitable to permit the creditor to apply the surplus value of one building toward a deficiency in value of the other building, even though the two debtors may have generally been operating as a

The "fair and equitable" requirement of Chapter X[7] means that each class of creditors, in descending rank, should receive full and complete compensation for the rights surrendered before the next lower class may participate. *Consolidated Rock Products Co.* v. *DuBois, supra,* 312 U.S. at 520-521; *Case* v. *Los Angeles Lumber Products Co., Ltd.,* 308 U.S. 106, 116-118. The bankruptcy court, having concluded that petitioner would receive the full benefit of the security for which it had bargained, properly found that the amended plan of reorganization was "fair and equitable" to petitioner within the meaning of Section 221(2) of the Bankruptcy Act, 11 U.S.C. 621 (2).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1976.

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single entity. While the liens in this case were not on buildings but on shifting collateral in the hands of the petitioner, there was no showing that petitioner's security had been impaired by the events which required consolidation. Under these circumstances, the bankruptcy court properly refused to allow consolidation, which would have resulted in the petitioner's receiving more security than it bargained for, to the prejudice and detriment of general creditors.

[7]See Sections 174 and 221(2) of Chapter X of the Bankruptcy Act, 11 U.S.C. 574 and 621(2).